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Supreme Court of the United States

October Term, 1992

MUSICK, PEELER & GARRETT, LEONARD CASTRO, ROBERT SCHUCHARD, J.H. COHN & CO. ED BACANI and ROBERT TORKAR,

Petitioners,

vs.

EMPLOYERS INSURANCE OF WAUSAU and FEDERAL INSURANCE COMPANY,

Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

BRIEF OF *AMICUS CURIAE* SECURITIES INDUSTRY ASSOCIATION IN SUPPORT OF RESPONDENTS

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I. INTERESTS OF *AMICUS CURIAE.*

The Securities Industry Association ("SIA") is a not-for-profit corporation formed under the laws of Delaware. It is the largest trade association of the securities industry, with over 650 broker-dealer and investment banking firm members in the United States and Canada. SIA's members are frequently named as defendants in federal securities fraud actions. In certain cases, those members seek to pursue claims for contribution against co-defendants or against persons not named as defendants by plaintiffs. In other cases, SIA's members are the targets of contribution claims by others. Accordingly, SIA has a substantial interest in the laws governing the rights of contribution among those potentially liable for violating the federal securities laws, and has sought and obtained the consent of all parties to file this *amicus curiae* brief on the merits.

II. INTRODUCTION AND SUMMARY OF ARGUMENT.

Sound policy considerations support the recognition, by this Court, of rights to contribution among those potentially liable for violations of Section 10(b) of the Securities Exchange Act of 1934 (the "1934 Act"), 15 U.S.C. § 78(j)(b), and Rule 10b-5 promulgated thereunder by the Securities and Exchange Commission ("SEC"), 17 C.F.R. § 240.10b-5. Absent such rights – first recognized by the federal courts over twenty years ago and now well-established in almost every circuit – securities fraud plaintiffs and their counsel would have the unfettered discretion to select which actors, among all of those potentially liable under Rule 10b-5, are called to account for their conduct. Leaving that choice entirely to plaintiffs

would lead to grossly unfair results, as relatively minor participants in an alleged fraud could be forced to bear the entire burden of defending against the charge, and the entire risk of an adverse judgment, while significantly more culpable participants remained untouched. Moreover, knowing that plaintiffs alone had the right to determine the scope of a Rule 10b-5 case, potential targets could be tempted to collude with them, at the expense of others at risk, to avoid being pursued themselves.

The attempts of petitioners and the *amicus curiae* supporting them to characterize contribution claimants as "wrongdoers," and their request that contribution rights be denied to those "guilty" of a scienter-based violation, should not distract this Court from the fairness considerations militating in favor of contribution. The availability of contribution under federal law does not depend upon whether the conduct at issue is characterized as "intentional" or "negligent." Indeed, the federal securities statutes explicitly authorize contribution claims by those "guilty of fraudulent misrepresentation" and those who "willfully" violate the law. Moreover, as this Court and others have recognized, once a class is certified in a Rule 10b-5 action, powerful pressures often force defendants to abandon meritorious defenses and settle even weak claims. To characterize such defendants as "intentional tortfeasors," and deny them contribution rights on that ground, would be to ignore the economic realities that drive large-scale securities fraud litigation.

Nor should this Court be swayed by petitioners' counterintuitive argument that contribution rights – which of course increase the likelihood that every culpable actor will be held to answer for participating in securities fraud – somehow lessen the deterrence effect of

Rule 10b-5. The authorities upon which petitioners and their supporters rely for this point are both inconclusive and inapposite, as they depend on assumptions that are drawn largely from antitrust law and do not hold true for securities litigation.

Similarly, petitioners' suggestion that contribution rights make settlement of Rule 10b-5 actions "unjustifiably difficult" is belied by history. Not only has there been no appreciably deleterious effect upon the pace of Rule 10b-5 settlements since such rights were first recognized by the federal courts over twenty years ago; securities fraud cases are now more likely to settle out of court than other civil actions. Even if the denial of contribution rights in Rule 10b-5 cases would increase plaintiffs' ability to extract pretrial settlements from their chosen targets, such a result, standing alone, would not justify an unfair rule of law.

As for petitioners' complaint that the lower federal courts have adopted inconsistent contribution standards and bar rules – leading to "confusion" in those courts – this hardly furnishes a legitimate reason for this Court to turn its back on the entire doctrine of contribution. On the contrary: it is the function of this Court to resolve such conflicts, and thereby bring consistency and predictability to the field. After considering the two leading approaches embraced by the lower federal courts, SIA recommends the proportionate fault rule announced in *Smith v. Mulvaney*, 827 F.2d 558 (9th Cir. 1987), and applied to partial pretrial settlements in *Franklin v. Kaypro Corp.*, 884 F.2d 1222 (9th Cir. 1989), *cert. denied*, 111 S. Ct. 232 (1990).

It is the proportionate fault rule – which ensures that all defendants taken to trial pay their fair share of the

total damages to plaintiffs, whether or not other defendants have previously settled out – that is most consistent with the basic fairness notions underlying the doctrine of contribution itself. In contrast, the *pro tanto* rule adopted by the Second Circuit – which renders nonsettling defendants arbitrarily liable for whatever portion of plaintiffs' damages have not already been paid in settlement – undermines the equities that contribution is supposed to ensure and improperly penalizes nonsettling defendants for exercising their right to trial.

The proportionate fault rule is fair to plaintiffs as well. Contrary to the claims of its critics, *Kaypro* does not deprive plaintiffs of any "right to be made whole." In fact, under *Kaypro*, a plaintiff entering into a partial settlement may, after trial, recover more than 100% of the total damages assessed by the jury. Moreover, the possibility – or even probability – of a different outcome is no reason to reject the rule. The settlement process properly entails compromises by plaintiffs as well as defendants. In return for the concrete benefits achieved through a partial settlement – certainty of the agreed-upon recovery, availability of funds with which to pursue the remaining defendants and simplification of further proceedings – it is hardly unfair to ask plaintiffs to bear some risk of a total recovery lower than that which the jury might have awarded had all defendants stood trial.

Finally, despite petitioners' assertion to the contrary, the proportionate fault rule, like the doctrine of contribution itself, is no obstacle to voluntary pretrial settlement of Rule 10b-5 actions. During the two years since *Kaypro* was decided, numerous partial settlements have been approved in securities fraud class actions within the

Ninth Circuit, followed in many cases by global settlements resolving all of plaintiffs' claims. Indeed, due to the high probability that such actions will ultimately result in global settlements, the net administrative burden to judges and juries is probably lower under the *Kaypro* rule than under the seemingly simpler *pro tanto* rule preferred by the plaintiffs' bar.

III. ARGUMENT.

A. Sound Policy Considerations Support Recognition Of Contribution Rights Among Those Charged With Rule 10b-5 Violations.

1. It would be fundamentally unfair to vest plaintiffs with the unilateral power to determine who will and who will not be held accountable under Rule 10b-5.

It is in the class action context that the debate concerning contribution rights under Rule 10b-5 takes on its true significance, due to the staggering costs of litigating such suits and the huge sums that may exchange hands at settlement or after trial. According to petitioners herein, the denial of contribution rights will not materially affect the scope of such suits, as "everyone who has potential culpability and either money or insurance is swept into class actions." Brief for Petitioners ("Pet. Br.") at 37. This assertion, however, is palpably false. Petitioners themselves, the lawyers and accountants advising the defendants in *In re Cousins Sec. Litig.*, No. 84-1821-B(IEG) (S.D. Cal.), were not sued by the plaintiffs who prosecuted Cousins and its directors. But for the availability, under settled Ninth Circuit law, of a contribution cause of action under Rule 10b-5, they could never have been "swept into" the litigation at all, whether by means of a third-

party complaint or – as it happened in this case – a second lawsuit after the underlying action was concluded.

The case at bar thus neatly illustrates the dangers inherent in denying contribution rights under Rule 10b-5. Absent such rights, many potentially liable (and solvent) actors will never be called to account for their role in the alleged violation. By the same token, those unlucky enough to become plaintiffs' targets will be forced, absent contribution rights, to bear the *entire* litigation burden and judgment risk in such cases, regardless of their level of culpability.

It takes but a brief glance at the economic structure of securities fraud class actions to understand why, in many cases, plaintiffs' selection of defendants does *not* include "everyone who has potential culpability and either money or insurance." The lawyers representing the class are paid handsomely, out of the class recovery, after settlement or trial. *See, e.g., In re Activision Sec. Litig.*, 723 F. Supp. 1373, 1377, 1379 (N.D. Cal. 1989) (noting that nearly all fee awards range around 30% of the class recovery, and awarding over $1.5 million, or almost 33% of the settlement fund, in the case at bar). Hoping to be named class counsel, plaintiffs' attorneys feel intense pressure to file their lawsuits as quickly as possible.[1]

[1] If the stakes are high enough, this pressure can provoke a virtual stampede to the courthouse and require judicial mediation. In *In re Oracle Sec. Litig.*, 131 F.R.D. 688 (N.D. Cal. 1990), four separate securities fraud class action complaints (and one derivative complaint) had been filed the day after the issuer announced disappointing earnings and suffered a large drop in its stock price. Fourteen additional lawsuits were initiated over the next two weeks. A bitter control contest between plaintiffs' firms ensued, ultimately resolved by a court-ordered bidding process for the position of class counsel. In *In re Continental Illinois Sec. Litig.*, 750 F. Supp. 868 (N.D. Ill. 1990), *rev'd on other grounds*, 962 F.2d 566 (7th Cir. 1992), nine law firms appeared on behalf of various plaintiffs and fought for the role of lead class counsel. Forced to referee their intramural dispute, the court noted, "What is really at stake in this unseemly contest is the financial interest of the lawyers, although, of course, the rhetoric is couched in terms of the welfare of the class." 750 F. Supp. at 875.

Unfortunately, "[t]he pressure to be the first or among the first to file a complaint precludes extensive pre-filing factual investigation." Janet C. Alexander, *Do The Merits Matter? A Study of Settlements in Securities Class Actions*, 43 Stan. L. Rev. 497, 513-14 (1991). In their rush to court, it is all too easy for plaintiffs' attorneys to concentrate only upon those actors whose potential culpability and financial wherewithal are readily apparent from publicly-available sources. Those whose roles in the alleged fraud are more difficult to uncover, and those whose finances are not easily assessed, may well be overlooked. Moreover, given that Rule 10b-5 liability is joint and several,[2] once plaintiffs have sued one or more defendants *with* "potential liability and either money or insurance," they have little incentive to broaden the scope of the lawsuit thereafter.

Haste and lack of motivation on plaintiffs' part are not the only reasons to fear that, absent contribution rights, culpable actors will escape Rule 10b-5 litigation, leaving others – whose degree of fault may be much lower – to bear the entire burden and risk of suit. A no-

[2] *See, e.g., Globus v. Law Research Service, Inc.*, 318 F. Supp. 955, 956 (S.D.N.Y. 1970), *aff'd per curiam*, 442 F.2d 1346 (2d Cir.), *cert. denied*, 404 U.S. 941 (1971).

contribution rule would encourage potential targets of Rule 10b-5 claims to engage in pre-filing bargaining with plaintiffs in an attempt to escape being named as defendants, inevitably raising the specter of collusion.[3] Indeed, given the high stakes in Rule 10b-5 class actions, the temptation for one potential defendant to exaggerate or even fabricate damaging information against another, in exchange for "immunity," could, in some cases, be overwhelming.

Contribution rights effectively guard against both dangers: inadvertence and collusion. Defendants, unlike plaintiffs, are strongly motivated to investigate and prosecute claims against those overlooked when the case was initially filed. Moreover, where contribution is available, potential defendants are unable to escape litigation by bargaining with plaintiffs alone. Thus, contrary to petitioners' contention, it is the *existence* of contribution rights that ensures, under current law, that "everyone with potential liability and either money or insurance" is "swept into" securities fraud class actions and, ultimately, that all culpable and solvent actors share the burdens and risks of Rule 10b-5 litigation.

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[3] *See* James S. O'Shaughnessy, *Judicial Implication of Contribution under Section 10(b) of the Securities Exchange Act: Is the New Branch on the Judicial Oak Threatened by Strict Statutory Construction?*, XVI Suffolk U. L. Rev. 983, 988-89 (1982) ("proscription of the right to contribution . . . encourages collusion and bribery between the plaintiff and potential defendants").

2. Rule 10b-5's scienter requirement is no reason to deny contribution rights to those charged by plaintiffs.

In an effort to defuse the powerful equitable arguments in favor of recognizing contribution rights among those faced with Rule 10b-5 claims, petitioners characterize contribution as "a right of a wrongdoer" and suggest that those "guilty" of securities fraud do not deserve to benefit from the doctrine. *See* Pet. Br. at 6, 14. The National Association of Securities and Commercial Law Attorneys ("NASCAT") is even more explicit: "Denying contribution to wrongdoers who act with scienter is by no means unfair. Anyone who wishes to avoid liability can easily do so by choosing not to commit securities fraud." Brief of *Amicus Curiae* National Association of Securities and Commercial Law Attorneys in Support of Petitioners ("NASCAT Br.") at 26.

Notably absent from these arguments, however, is any reference to the federal securities statutes that petitioners and NASCAT parse so closely elsewhere in their briefs. And for good reason: those statutes reveal that Congress had no particular liking for, and no inclination to perpetuate, the traditional common-law distinction between negligent and intentional tortfeasors, nor to deny contribution rights among the latter.

Section 11(f) of the Securities Act of 1933 (the "1933 Act"), 15 U.S.C. § 77k(f), explicitly authorizes contribution claims among those liable under Section 11(a), 15 U.S.C. § 77k(a), "unless the person who has become liable *was*, and the other *was not*, guilty of fraudulent misrepresentation." (Emphasis added.) Contribution between two persons *both* "guilty of fraudulent misrepresentation" has thus been affirmatively endorsed by Congress. Similarly,

Section 9(e) of the 1934 Act, 15 U.S.C. § 78i(e), explicitly permits contribution claims among those who "willfully" participated in manipulation of security prices. And Section 18(b) of the 1934 Act, 15 U.S.C. § 78r(b), permits contribution, without regard to level of fault, between persons liable for misleading statements filed with the SEC. Thus, all three explicit grants of contribution rights found in the federal securities statutes permit such rights to be asserted by intentional or willful "wrongdoers." Whatever Congress's intention might have been with respect to Section 10(b) of the 1934 Act and Rule 10b-5 (had it contemplated private litigation thereunder), it clearly did *not* intend to condition the availability of contribution claims for securities fraud on the claimant's lack of scienter.

Petitioners' sanctimonious characterization of contribution claimants as "wrongdoers" – morally undeserving of the "benefits" of contribution due to the allegedly "septic state" of their hands – suffers from a second flaw as well. A growing body of evidence suggests that neither the filing nor the settlement of a Rule 10b-5 class action is a reliable indicator of the "guilt" of any defendant. Instead, recent increases in the pace of such filings and the level of such settlements are attributable, at least in part, to the peculiar economics of securities fraud class litigation.

Securities class actions tend to be filed whenever an issuer's stock price suffers a precipitous decline large enough for the total potential damage award to the shareholders to support an award of attorneys' fees that would make it worthwhile to bring a case." Alexander, *supra*, 43 Stan. L. Rev. at 513. Professor Alexander's study – based on a group of Northern California "high-tech" companies

that went public in the 1980s – thus indicates that the institution of such a suit may have little to do with whether any actual fraud has occurred. *See id.* at 514. Other commentators agree. *E.g.*, Vincent O'Brien, *The Class Action Shake-Down Racket*, Wall St. J., Sept. 10, 1991, at A20 ("any company whose stock price declines is open to a class action suit"); Note, *Using Rule 9(b) to Reduce Nuisance Securities Litigation*, 99 Yale L.J. 1591, 1594 (1990) ("The inherent characteristics of . . . rule 10b-5 class action litigation, as well as the economic incentives facing a professional plaintiff's attorney, create strong incentives for the initiation of such actions").

Once a Rule 10b-5 lawsuit has been filed, it is relatively easy for plaintiffs to obtain an order certifying a class.[4] And once a class has been certified, defendants face powerful pressures to settle – as most of them do[5] – regardless of the merits of the charges against them. For one thing, it is cheaper for a plaintiff to prosecute such a case than for a defendant to resist it. This "litigation differential," which "exists independently of the merits of the plaintiff's claim," is particularly marked in Rule 10b-5 cases, where massive one-way discovery is the rule. Note, *supra*, 99 Yale L.J. 1596-97. Moreover, the size of the potential damages award in a class action, even where discounted to reflect a low probability of an adverse

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[4] Under federal law, the merits of the plaintiffs' claims are not considered at the class certification stage. *Eisen v. Carlisle & Jacquelin*, 417 U.S. 156, 178 (1974). Moreover, given this Court's decisions in *Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1972), *reh'g denied*, 408 U.S. 931 (1972), and *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988), the reliance element of a Rule 10b-5 claim rarely precludes class certification.

[5] *See* Part III(A)(4), *infra*.

verdict, is enough to give any defendant pause. Thus, as this Court noted in *Coopers & Lybrand v. Livesay*, 437 U.S. 463, 476 (1978), "Certification of a large class may so increase the defendant's potential damages liability and litigation costs that he may find it economically prudent to settle and to abandon a meritorious defense."

The pendency of Rule 10b-5 claims also interferes with defendants' ordinary business activities, resulting in additional settlement pressure. "There has been widespread recognition that litigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general." *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 739 (1975). "The very pendency of the lawsuit may frustrate or delay normal business activity of the defendant which is totally unrelated to the lawsuit." *Id.* at 740.

Finally, many defendants in Rule 10b-5 actions are insured by policies prohibiting indemnification after an actual adjudication of fraud. *See* John C. Coffee, Jr., *Understanding the Plaintiff's Attorney: The Implications of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions*, 86 Colum. L. Rev. 669, 715-16 (1986). In order to avoid even a low risk of such an adjudication at the hands of a capricious jury, many defendants (like the defendants in the *Cousins* litigation underlying this action) prefer to enter into settlement agreements which permit them to deny liability and tap their insurance policies to pay all or part of the settlement sum.

All of these factors combine to ensure that, under existing law, Rule 10b-5 class actions are often filed, prosecuted and ultimately settled in a manner that bears little or no relationship to the presence or absence of

actual fraud on the part of any defendant. Thus, it is simply not the case that "[a]nyone who wishes to avoid liability can easily do so by choosing not to commit securities fraud." NASCAT Br. at 26.[6] By the same token, it is somewhat disingenuous for petitioners and NASCAT to speak of contribution claimants – often, as in the case at bar, defendants who have settled or wish to settle the claims against them with no admission of liability – as "wrongdoers" who do not deserve the "benefits" of contribution.

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[6] A recent Ninth Circuit case, though not addressed to contribution issues, provides a good illustration of this point. In *Layman v. Combs*, No. 89-16621, 1992 WL 368854 (9th Cir. Dec. 17, 1992), plaintiffs sued numerous defendants pursuant to Rule 10b-5 and other laws for their losses resulting from investments in a thoroughbred horse breeding operation. The trial court granted summary judgment to defendants on certain claims and directed a verdict in their favor on others. The jury then returned a complete defense verdict on the remaining claims. Defendants' victory, however, was no bargain. Indeed, although they were fully exonerated of all charges of securities fraud, they hardly escaped "liability" in the broader sense of the word. As Judge Kozinski explained (dissenting from the majority's affirmance of the district court's rejection of seven defendants' counterclaims for legal fees): "This litigation – although it resulted in a complete defense victory, mostly on summary judgment – devoured a staggering quantity of productive resources. . . . *The attorneys' fees, for the seven defendants who requested them, amounted to more than $3.5 million. This says nothing of the fees incurred by the 13 plaintiffs and the 14 defendants who didn't request reimbursement.*" 1992 WL at *11 (emphasis added). "If this is the face of victory," Judge Kozinski asked, "how much uglier could defeat be?" *Id.* at *12 n.3. Undoubtedly, many securities fraud defendants ask themselves the same question when contemplating the steep price of seeking judicial exoneration.

3. The threat of contribution claims tends to increase the deterrence effect of Rule 10b-5.

It is easy to understand why so many lower federal courts have concluded that the availability of contribution rights adds to the power of Rule 10b-5 to deter fraud.[7] Put succinctly:

> To the extent that potential wrongdoers are aware of the rule allowing contribution, it can be said to deter violations by reducing the possibility that any participant in a securities fraud scheme will escape liability completely. Thus, a wrongdoer cannot hope to avoid liability simply because the plaintiff fortuitously may fail to include that wrongdoer as a defendant.

M. Patricia Adamski, *Contribution and Settlement in Multiparty Actions under Rule 10b-5*, 66 Iowa L. Rev. 533, 540 (1981) (footnotes omitted).

The contrary argument is also easy to state. Those who contend that contribution weakens the deterrent power of Rule 10b-5 reason, in essence, that persons contemplating securities fraud will be better deterred by a low risk that they could be held solely liable for the entire amount of any resulting damages than by a higher

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[7] *See, e.g., Tucker v. Arthur Andersen & Co.*, 646 F.2d 721, 727 n.7 (2d Cir. 1981); *Huddleston v. Herman & MacLean*, 640 F.2d 534, 558 n. 44 (5th Cir. 1981), *aff'd in part, rev'd in part on other grounds*, 459 U.S. 375 (1983); *Laventhol, Krekstein, Horwath & Horwath v. Horwitch*, 637 F.2d 672, 675 (9th Cir. 1980), *cert. denied*, 452 U.S. 963 (1981); *Heizer Corp. v. Ross*, 601 F.2d 330, 332 (7th Cir. 1979).

risk that they could be held liable for a portion of those damages. *See* NASCAT Br. at 16-17.[8]

Although NASCAT attempts to suggest otherwise in its brief, no circuit has endorsed this anti-contribution argument in a securities fraud case.[9] There are several reasons, moreover, why it should be treated with great suspicion. First, as this Court has previously acknowledged, "Economists disagree over whether business decisionmakers . . . are 'risk averse'; *i.e.*, [whether] they

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[8] There is, of course, a third possibility: that contribution has no effect upon deterrence at all, either because persons contemplating securities fraud do not bother to calculate its effects or because – as petitioners themselves assert – those effects are so unpredictable that potential tortfeasors "could not rationally take [contribution] into account in deciding how to act." Pet. Br. at 37-38. Curiously, petitioners appear either unaware of or unconcerned by the obvious inconsistency between this statement and their contention, elsewhere in their brief, that a no-contribution rule "would be the most effective deterrent of violation of securities laws." *Id.* at 9.

[9] *See* NASCAT Br. at 17 n.17. The two securities opinions cited therein – only one of which was an appellate decision – stop well short of concluding that a no-contribution rule would enhance the deterrence effect of Rule 10b-5. *Baker, Watts & Co. v. Miles & Stockbridge*, 876 F.2d 1101 (4th Cir. 1989), involved Section 12(2) of the 1933 Act, 15 U.S.C. § 77l(2). The court stated, "It is *unclear* whether a federal right of action for contribution would promote the general purposes of the federal securities laws," then, based on the language of § 12(2), held that no indemnity or contribution claims were permitted under that section. 876 F.2d at 1105-06 (emphasis added). In *In re Olympia Brewing Co. Sec. Litig.*, 674 F. Supp. 597, 616 n.20 (N.D. Ill. 1987), the district court was even more tentative, noting only that certain "contemporary analysis" indicates that a no-contribution rule "*may* provide *as great* a deterrent . . . as a rule permitting contribution," then expressly announcing, "This court takes *no position* on the issue here." (Emphasis added.)

would prefer a greater certainty of a small loss to a less certain chance of a greater loss." *Texas Industries, Inc. v. Radcliff Materials, Inc.*, 451 U.S. 630, 636 n.8 (1981). Although encouraged to do so by the parties and numerous *amici* in that antitrust action, the Court in *Texas Industries* pointedly refused to resolve the debate, thus leaving one of the fundamental assumptions underlying the anti-contribution argument unresolved.[10]

Even if this Court were to believe that a no-contribution rule would best deter *antitrust* violations, it should not apply the same logic to the field of securities fraud litigation.[11] The plaintiffs' securities bar, as noted in Part

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[10] Indeed, even the strongest proponents of the anti-contribution view – the three University of Chicago Law School scholars (two of whom have since become federal judges) who developed the economic argument adopted by NASCAT herein – admitted, in their seminal article, that "the extent and intensity of risk aversion among firms is an unsettled empirical question." Frank H. Easterbrook, William M. Landes & Richard A. Posner, *Contribution Among Antitrust Defendants: A Legal and Economic Analysis*, 23 J. Law & Econ. 331, 353 n.50 (1980). More than a decade later, this question remains, at best, unsettled. *See* John A. Langmore & Robert A. Prentice, *Contribution Under Section 12 of the Securities Act: The Existence and Merits of Such a Right*, 40 Emory L.J. 1015, 1079-80 (1991) (noting that "[m]ore recent evidence indicates that individuals are not uniformly risk-averse" and concluding that, "it is *incorrect* to assume that the smaller threat of a bigger penalty deters wrongful conduct more effectively than the more certain threat of a smaller penalty" (emphasis added).)

[11] It should be noted, in this regard, that only one of the scholarly analyses cited by NASCAT to support its conclusion that contribution weakens deterrence addresses the specific issue of securities fraud. And that article, in turn, draws heavily and uncritically on the seminal work of the Chicago scholars in the antitrust field. Mark J. Lowenstein, *Implied Contribution*

III(A)(1), *supra*, is subject to intense economic pressure to file class action complaints in great haste, with little opportunity for thorough investigation of all potential defendants. Antitrust plaintiffs, on the other hand, do not ordinarily feel the same compulsion to race to the courthouse, and thus are less likely to overlook potentially culpable and solvent defendants. Moreover, securities fraud plaintiffs do not need to allege or establish any conspiracy, agreement or common course of conduct to state an actionable claim under Rule 10b-5 (or, for that matter, to recover the highest possible damages).[12] Antitrust plaintiffs, however, are virtually compelled, by the nature of the claims they assert, to proceed against multiple defendants. *See* Easterbrook, Landes & Posner, *supra*, 23 J. Law & Econ. at 344 (noting that their analysis is "tailored to cases in which there can be no harm unless one or more wrongdoers collaborate").

For both of these reasons, securities fraud plaintiffs are less likely than antitrust plaintiffs to name all potentially liable actors as defendants. Therefore, in the absence of contribution rights, violators of the securities laws are more likely than violators of the antitrust laws to escape the burdens and risks of litigation altogether. By the same token, the availability of contribution rights increases the risk that securities law violators will be called to account to a greater degree than it increases the same risk for antitrust violators. This fundamental

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Under the Federal Securities Laws: A Reassessment, 1982 Duke L.J. 543, 556-57 & 572-73 (1982).

[12] Indeed, Rule 10b-5 defendants need not even admit to any concerted action in order to state contribution claims against co-defendants or third parties. *See Marrero v. Abraham*, 473 F. Supp. 1271, 1276-78 (E.D. La. 1979).

change to the risk calculus underlying the work of the Chicago scholars renders their conclusions – even if otherwise supportable – inapplicable to the case at bar. In the unique arena of large-scale securities fraud litigation, contribution is the best and perhaps the only mechanism for ensuring that all culpable actors are called to account. As such, contribution rights can only increase the deterrence effect of Rule 10b-5.

4. The availability of contribution rights has no adverse effect on the ability of litigants to fashion just pretrial settlements in Rule 10b-5 cases.

Petitioners claim that "[c]ontribution . . . makes securities actions unjustifiably difficult to settle." Pet. Br. at 9. Given the dramatic empirical evidence to the contrary, this assertion must be viewed, at best, as hyperbole.

The first reported federal decision authorizing contribution claims under Rule 10b-5 was *deHaas v. Empire Petroleum Co.*, 286 F. Supp. 809 (D. Colo. 1968), *aff'd in part, rev'd in part on other grounds*, 435 F.2d 1223 (10th Cir. 1970). For more than two decades thereafter – as one court after another agreed with *deHaas* and recognized the contribution rights of Rule 10b-5 defendants – the pace of settlements in such cases apparently *increased*. By the early 1990s – when every circuit which had spoken on the issue agreed that contribution rights were available under Rule 10b-5 – securities fraud class actions were significantly *more* likely to settle than other types of civil litigation. *Compare* Thomas M. Jones, *An Empirical Examination of the Resolution of Shareholder Derivative and Class Action Lawsuits*, 60 B.U. L. Rev. 542, 544-47 (1980) (71% of shareholder class and derivative actions tracked throughout the 1970s settled before trial) *with* O'Brien, *supra* (96%

of securities fraud class actions over past three years settled out of court, compared to 60-70% for other civil cases). *See also* Alexander, *supra*, 43 Stan. L. Rev. at 525 ("the settlement rate for securities class actions is much higher than for civil litigation generally"); Melvyn I. Weiss, *Class Action Suits Are a Shield for Shareholders*, Wall St. J., Jan. 30, 1992, at A13 (conceding, in response to O'Brien, that "most securities class actions are resolved through settlement").

Even assuming, *arguendo*, that a no-contribution rule might increase the pace (or the level) of settlements in securities fraud actions, the possibility of this result, standing alone, would hardly justify the adoption of such a rule by this Court.

> Trial courts in which litigation is pending have a natural desire to clear court dockets of complex litigation in an expeditious a manner as possible. *This desire, however, is tempered by the need to assure factual fairness and the correct application of legal principles.*

Kaypro, 884 F.2d at 1225 (emphasis added). While the federal courts rightly encourage fair settlements, no responsible jurist or commentator suggests that settlement should be a goal in and of itself, regardless of the merits of the litigation. As noted in Part III(A)(2), *supra*, existing law tends to coerce settlements in Rule 10b-5 class actions, even where plaintiffs' claims are tenuous at best. There is no justification for a rule of law that would put further pressure on innocent actors to settle.

B. Sound Policy Considerations Support The Endorsement Of The *Kaypro* Proportionate Fault Rule By This Court.

Petitioners' final policy argument against the recognition of contribution rights in Rule 10b-5 cases is their

claim that the need for the lower federal courts to fashion contribution bar rules for use in partial settlement cases "causes confusion and case management problems in the lower federal courts." Pet. Br. at 39. They contend that neither the proportionate fault approach endorsed by the Ninth Circuit in *Kaypro* nor the *pro tanto* approach adopted in *Singer v. Olympia Brewing Co.*, 878 F.2d 596 (2d Cir. 1989), *cert. denied*, 111 S. Ct. 232, 493 U.S. 1024 (1990), is "satisfactory." *Id.* Therefore, petitioners reason, it would be best for this Court simply to abandon the entire notion of contribution.

What petitioners overlook is that the "problems" they posit will face the lower federal courts in the vast majority of securities fraud actions *regardless* of whether contribution rights are available under Rule 10b-5. Most cases arising out of public offerings of securities (like *Cousins* itself) include, in addition to Rule 10b-5 counts, claims under Section 11 of the 1933 Act, which expressly permits contribution.[13] Moreover, many Rule 10b-5 cases – including open-market class actions and even customer disputes – include one or more pendent claims pleaded under state blue sky statutes or common law. In a growing number of jurisdictions, these counts also require the courts "to consider how to administer contribution

[13] *See Herman & MacLean v. Huddleston*, 459 U.S. 375, 380-87 (1983) (fraudulent registration statements are actionable under both § 11 and Rule 10b-5). Moreover, given that § 11 does not require any showing of scienter, it would be unrealistic in the extreme to expect a plaintiff to forego a § 11 claim merely to avoid the "complications" stemming from its contribution provision.

fairly." Pet. Br. at 38.[14] Thus, the no-contribution rule sought by petitioners under Rule 10b-5 would not significantly relieve the lower federal courts – or the litigants – of any administrative burden when fashioning settlement agreements.

As for the claim that the current *conflict* between the circuits is the cause of unacceptable "confusion" in the trial courts, Pet. Br. at 39, this Court, of course, is uniquely situated to resolve that conflict and alleviate any such confusion. In fact, SIA agrees with NASCAT that this Court should (in addition to recognizing a right to contribution in Rule 10b-5 cases) "giv[e] lower courts and litigants some indication of just *what* that right to contribution *is*." NASCAT Br. at 27 (emphasis in the original).

[14] *See, e.g.*, Cal. Corp. Code § 25505 (expressly authorizing contribution claims based on proportionate fault under state securities statutes); *Harrison v. Sheats*, 608 F. Supp. 502 (E.D. Cal. 1985) (approving partial settlement in securities fraud action containing claims under federal and California securities statutes and common law fraud, all requiring consideration of contribution rights); *Ballis v. Evans*, No. 84C9340, 1986 WL 12274, at *2 (N.D. Ill. Oct. 28, 1986) (concluding, in action arising out of sale of oil well interests, that contribution rights are available under Illinois common law as well as federal securities laws, but that defendant's third-party complaint failed to state contribution claim); *McLean v. Alexander*, 449 F. Supp. 1251, 1265 (D. Del. 1978), *rev'd on other grounds*, 599 F.2d 1190 (3d Cir. 1979) (holding, in action arising out of sale of common stock, that "[i]n addition to the right of contribution under federal securities laws, defendant has a statutory right to contribution under [Delaware] state law"). These state-law claims often entitle plaintiffs to seek punitive or emotional distress damages or enjoy other advantages unavailable under Rule 10b-5. Thus, once again, it is unlikely that the "complications" flowing from the availability of contribution will cause plaintiffs to abandon them when filing Rule 10b-5 actions.

1. The proportionate fault rule is most consistent with the basic fairness notions underlying the doctrine of contribution.

The first few courts to authorize contribution claims in Rule 10b-5 cases apportioned damages on a *pro rata* or "per head" basis. *E.g., Globus,* 318 F. Supp. at 957-58. Judges and commentators quickly moved away from that approach, however, for reasons well summarized in *Smith,* 827 F.2d at 561. Noting that Congress did not likely intend the *pro rata* rule to be used under the 1933 and 1934 Acts, and that the administrative convenience it afforded was "minimal," the Ninth Circuit opted to apportion liability according to the relative culpability of the parties. The court concluded that such a rule:

> appears especially appropriate in securities fraud cases which include numerous defendants with potentially vast differences in culpability. *Contribution is an equitable doctrine. To apportion damages without regard to fault reduces, to an extent, the equity which the doctrine was intended to provide.* . . . This court, therefore, finds the relative culpability measure appropriate.

Id. (Emphasis added.)

Two years later, in *Kaypro,* the Ninth Circuit applied the same equitable principles to partial pretrial settlements in Rule 10b-5 actions. Under *Kaypro,* once a partial settlement is approved by the trial court pursuant to Fed. R. Civ. P. 23, the nonsettling defendants are "barred from further rights of contribution from the settling defendants." 884 F.2d at 1231. Thereafter, should the plaintiffs proceed to trial against the remaining defendants, the jury is asked to determine:

> the percentage of culpability of each of the nonsettling defendants as well as that of the settling defendants. Nonsettling defendants as a whole

> will then be required to pay the percentage of the total amount for which they are responsible . . . and will continue to have rights of contribution [governed by the proportionate fault rule of *Smith*] against one another.

Id.

The Second Circuit, on the other hand, has never moved away from the *pro rata* rule first accepted – with virtually no analysis – in *Globus. See, e.g., Herzfeld v. Laventhol, Krekstein, Horwath & Horwath,* 540 F.2d 27, 39 (2d Cir. 1976). Because that court has never committed itself to apportioning liability equitably in the absence of a settlement, it is not surprising that it gives equally short shrift to equitable principles in fashioning a rule for use in partial settlement cases. Instead, under the *pro tanto* rule announced in *Singer,* the nonsettling defendants will automatically become liable for the entire amount of the damages found by the jury, less "a credit of the settlement amount." 878 F.2d at 600.

The injustice inherent in the *Singer* scheme is readily apparent. Indeed, it effectively operates to reinstate the very inequities that contribution is intended to prevent, by encouraging collusion between plaintiffs and settling defendants and rendering nonsettling defendants arbitrarily liable for sums that may bear no relationship to their culpability. *See Kaypro,* 884 F.2d at 1230. Worse yet, even if the trial court conducts a rigorous "fairness hearing" before approving a partial settlement,[15] the *pro tanto*

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[15] In an attempt to mitigate the harshness of the *pro tanto* rule, many courts conduct an in-depth review of the proposed partial settlement – designed to ensure that the settling defendants are paying an appropriate share – before approving it and entering a contribution bar. *See, e.g., In re Atlantic Fin. Manage-*

rule almost always forces the nonsettling defendants to pay *more than* their fair share of any liability assessed by the jury, because a "fair" settlement payment invariably incorporates a cost and/or risk discount. *Id.* The *pro tanto* rule thus improperly penalizes nonsettling defendants for exercising their rights to trial.

As between the two models examined above, only *Kaypro* is faithful to the equitable principles underlying the doctrine of contribution itself. It permits defendants to settle without risk of contribution claims thereafter, yet it neither penalizes nor rewards nonsettling defendants for exercising their right to trial. Instead, those nonsettling defendants continue – as they should – to face a risk of liability proportionate to their level of culpability. As the Second Circuit itself admitted, "the proportionate method is always consistent with fault." *In re Masters Mates & Pilots*, 957 F.2d at 1029.

2. The proportionate fault rule does not unfairly disadvantage plaintiffs.

According to NASCAT, the proportionate fault rule set out in *Kaypro*, though it may be fair to *defendants*, is unfair to *plaintiffs* because it requires them to "forfeit their right to be made whole when liability is established

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ment Inc. Sec. Litig., 718 F. Supp. 1012, 1017 (D. Mass. 1988). *Singer* itself made no mention of any pre-settlement fairness hearing as a precondition to a contribution bar. Three years later, however – in a class action arising under the pension laws rather than the securities laws but likely intended to be applicable to Rule 10b-5 cases – the Second Circuit stated that a district court must conduct such a hearing before approving a partial settlement and entering a contribution bar. *In re Masters Mates & Pilots Pension Plan and IRAP Litig.*, 957 F.2d 1020, 1031-32 (2d Cir. 1992).

after trial." NASCAT Br. at 18, 20. As an example, NASCAT constructs a hypothetical case in which plaintiffs settle with one defendant for $100,000, then convince the jury, after trial against the remaining defendant, that their total damages are $10 million. Under *Kaypro*, they point out, the jury might determine that the nonsettling defendant was only 50% liable for their damages, thus limiting their recovery to $5 million from that nonsettling defendant and their total recovery to $5.1 million, $4.9 million less than they theoretically would have been entitled to had they proceeded to trial against both defendants. *Id.* at 21-22.

What its critics tend to ignore, however, is that the *Kaypro* rule could just as easily work in plaintiffs' favor.[16] Indeed, the Ninth Circuit explicitly recognized that the rule it adopted could lead to a plaintiffs' windfall. *Kaypro*, 884 F.2d at 1231-32 (discussing the "one satisfaction rule" and determining that it would not be violated where "plaintiffs are merely receiving more money than they *might* have in different circumstances") (emphasis in the original).[17]

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[16] If, in the same $10 million case, the first defendant paid $6 million in settlement and the jury determined that the second defendant was 90% liable for plaintiffs' damages, plaintiffs would be permitted to collect $9 million from that second defendant, for a total recovery of $15 million, $5 million *more* than if they had proceeded to trial against both defendants. Even if the jury returned a defense verdict, plaintiffs would still be left with their $6 million settlement payment from the first defendant, which would, under those circumstances, be $6 million more than the jury intended them to recover.

[17] Both petitioners and NASCAT argue that *Kaypro* encourages the nonsettling defendant to pursue the "empty chair" defense; that is, to attempt, at trial, to convince the jury that the

Even if the *Kaypro* rule tended, on balance, to result in a lower recovery to plaintiffs than the total damages awarded by the jury, it should not, for that reason, be rejected as unfair. Contrary to NASCAT's contentions, a plaintiff who has accepted the benefits of a pretrial settlement has no inherent "right," thereafter, to be "made whole." A settlement agreement, by definition, entails compromise. It necessarily requires each settling party to give up rights it would otherwise preserve through trial. Indeed, when a simple one plaintiff/one defendant lawsuit settles, plaintiff obtains a certain and prompt recovery but, to the extent that the agreed-upon payment is lower than the total damages claimed (as it almost always is), must also relinquish all hope of being "made whole."

Similarly, when plaintiffs in a multi-party action enter into a partial pretrial settlement with some but not all defendants, they obtain a certain and prompt recovery and insure themselves against the risk that they may recover nothing at trial. In addition, a partial settlement tends to strengthen plaintiffs' case against the remaining

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absent settling defendant was primarily to blame for plaintiffs' losses. *See* Pet. Br. at 39; NASCAT Br. at 22. As a practical matter, however, such a strategy may actually increase the risk, to the nonsettling defendant, of an adverse verdict on the threshold question of liability. *See* Langmore & Prentice, *supra*, 40 Emory L.J. at 1095 (noting that, where contribution claims among defendants are tried together with plaintiff's claims, "by the time defendants are done pointing fingers at each other, they have gone a long way toward making the plaintiff's case"). Moreover, it is by no means obvious that the plaintiff is worse off in an "empty chair" trial – when it can focus all of its efforts on attacking the nonsettling defendant – than it would have been had it proceeded to trial against all defendants and been required to construct a case against each.

defendants by providing them with a "war chest" to fund their efforts and by permitting them to concentrate, thereafter, only upon the liability of the nonsettling defendants. *See Kaypro*, 884 at 1225; *United States Fidelity & Guar. Co. v. Patriot's Point Dev. Auth.*, 772 F. Supp. 1565, 1575 (D.S.C. 1991). It is hardly unfair to ask plaintiffs, after accepting these benefits, also to accept *some* risk that their total recovery after trial may be lower than it might have been had there been no settlement.

3. The proportionate fault rule does not impede fair settlements nor unduly burden the courts.

Once again indulging a penchant for hyperbole, petitioners assert that the proportionate fault rule "has nearly terminated partial settlements of class actions in the Ninth Circuit." Pet. Br. at 39. In fact, the trade press has reported many such settlements within the Ninth Circuit since *Kaypro* was decided.[18] And in more than a few of

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[18] See Securities Class Action Alert, Vol. 5, No. 12, at 19 (Dec. 1992) ($1.25 million paid in *Klein v. King*, No. C-88-3141-FMS (N.D. Cal.)); *id.*, Vol. 5, No. 9, at 10 (Sept. 1992) (over $2.8 million in cash paid and $8.5 million in stock issued in *In re L.A. Gear Sec. Litig.*, Master File No. 90-2832-KN (C.D. Cal.)); *id.*, Vol. 5, No. 4, at 43 (Apr. 1992) and Vol. 5, No. 3, at 20 (Mar. 1992) ($425,000 paid pursuant to two different partial settlement agreements in *In re Ramtek Sec. Litig.*, No. C-88-20195-JW (N.D. Cal.)); *id.*, Vol. 5, No. 8, at 32 (Aug. 1992) ($15 million paid in *Roberts v. Heim*, Nos. C-84-8069-TEH, C-87-6174-TEH and C-88-3373-TEH (N.D.Cal.)); *id.*, Vol 5, No. 4, at 34 (Apr. 1992) ($9.5 million paid in *In re Precious Metals Dealers Litig.*, Nos. 90-5124-RSWL, 91-5085-RSWL, 91-5086-RSWL, 91-5087-RSWL and 91-5333-RSWL (C.D.Cal.)); *id.*, Vol. 5, No. 9, at 1 (Sept. 1992), Vol. 5, No. 5, at 1 (May 1992) and Vol. 3, No. 9, at 15 (Sept. 1990) (over $225 million paid pursuant to

those cases plaintiffs were represented by the same firms that now criticize *Kaypro*, in their *amicus* brief, on the ground that it "impairs settlement." NASCAT Br. at 27.

A moment's reflection, moreover, reveals that if the proportionate fault rule inhibits settlement at all, only inadequate settlements are impeded. When settling defendants pay their appropriate share, plaintiffs have nothing to fear from the operation of the *Kaypro* rule at trial. *See In re Sunrise Sec. Litig.*, 698 F. Supp. 1256, 1259 (E.D. Pa. 1988) ("the only settlements which the *pro tanto* rule would produce that the proportional rule would not are ones in which a defendant settles for less than his likely share of liability at trial"). As noted in Part III(A)(4), *supra*, the judiciary's preference for settlement over trial is intended to encourage equitable out-of-court

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three different partial settlement agreements in *In re American Continental Corp./Lincoln Sav. & Loan Sec. Litig.*, MDL No. 834 (D. Ariz.)); *id.*, Vol. 4, No. 10, at 7 (Oct. 1991) ($6.8 million paid in *In re Melridge, Inc. Sec. Litig.*, Master File No. 87-1426-JU (D. Or.)); *id.*, Vol. 4, No. 9, at 20 (Sept. 1991) ($26 million in cash plus stock paid in *In re Software Toolworks Inc. Sec. Litig.*, Master File No. 90-2906-FMS (N.D. Cal.)); *id.*, Vol. 4, No. 7, at 19 (July 1991) (over $20 million paid by law firm defendants in *Bertiand v. Industrial Dev. Auth.*, CIV 89-1087-PHX-RCB (D. Ariz.), after prior partial settlement reached with accountants); *id.*, Vol. 4, No. 5, at 27 (May 1991) ($775,000 paid in *Appleton v. McGladrey & Pullen*, MDL-841-R (C.D. Cal.)); *id.*, Vol. 4, No. 7, at 15 (July 1991) ($10.1 million paid in *In re Beverly Hills Sav. & Loan Ass'n Sec. Litig.*, Master File No. 85-3157 RMT (C.D. Cal.)); *id.*, Vol. 4, No. 6, at 15 (June 1991) ($7.25 million paid in *Tonnemacher v. Sasak*, CIV 89-0201-PHX-SMM (D. Ariz.)); *id.*, Vol. 3, No. 4, at 15 (Apr. 1990) ($1 million paid in *Securities Investors Protection Corp. v. Vigman*, CV-4742-AWT (C.D. Cal.)); *id.*, Vol. 3, No. 3, at 11 (Mar. 1990) ($10 million paid in *Stein v. Marshall*, Master File No. 89-0066-PHX-CAM (D. Ariz.)); *id.*, Vol. 3, No. 3, at 37 (Mar. 1990) ($4.85 million paid in *In re FPI/Agretech Litig.*, MDL No. 763 (D. Haw.)).

resolutions, not coercive settlements unrelated to the merits of the litigation.

Finally, petitioners and NASCAT argue that trial after a partial settlement is more cumbersome under the *Kaypro* rule than under the *pro tanto* rule. *See* Pet. Br. at 39; NASCAT Br. at 24. This perceived disadvantage, however, must be balanced against the fact that the partial settlement process itself is more cumbersome in most *pro tanto* jurisdictions – due to the intensive fairness hearing required at that stage – than it is in the Ninth Circuit. *See In re Atlantic*, 718 F. Supp. at 1017 (noting that a fairness hearing, unlike an ordinary Rule 23 hearing, requires the court to assess "the strength of plaintiffs' case against each defendant as to liability and the relative blameworthiness of its conduct"); *In re Masters Mates & Pilots*, 957 F.2d at 1032 (adding that the district court "should conduct an *evidentiary* hearing when one is sought") (emphasis added). Moreover, partial settlements are frequently followed by global settlements that resolve all of plaintiffs' claims and obviate any need for trial.[19] Thus, on balance, the *Kaypro* rule – which does not require judges or juries to assess the relative culpability of settling and nonsettling defendants unless and until the case goes to trial – may more effectively conserve judicial resources than the seemingly simpler *pro tanto* rule.[20]

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[19] Indeed, three years after *Kaypro* itself was decided, the remaining defendants settled with plaintiffs. *See* Securities Class Action Alert, Vol. 5, No. 9, at 46 (Sept. 1992).

[20] As for the danger of "second generation" lawsuits posed by the decision below, *see* NASCAT Br. at 24, SIA respectfully suggests that this Court could easily curtail such litigation without doing violence to the principle of proportionate fault. Because a claim for contribution ordinarily accrues when the

IV. CONCLUSION.

For all of the reasons stated above, SIA urges this Court to recognize rights of contribution among those charged with violating Rule 10b-5, and to mandate that liability be apportioned according to their relative culpability.

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claimant itself is charged with misconduct, not when it settles or is adjudicated liable, a Rule 10b-5 defendant may, if it so chooses, assert whatever contribution claims it has against non-parties pursuant to Fed. R. Civ. P. 14(a) during the pendency of the case against it. *See Marrero*, 473 F. Supp. at 1275 ("Every court that has considered the question has allowed additional tortfeasors in Rule 10b-5 cases to be joined as third-party defendants when the plaintiff has failed to join them as direct defendants") (citations omitted). It would be not be unreasonable for this Court prospectively to require a Rule 10b-5 defendant to avail itself of Rule 14(a) prior to settling with plaintiffs, on pain of losing its contribution rights thereafter. This would permit the district court to deal with all potentially liable parties, and all contribution issues, in one action, obviating any need for follow-on suits.

* The above-listed attorneys gratefully acknowledge the assistance of Ronit Setton, an employee of Orrick, Herrington & Sutcliffe who recently passed the New York bar examination and will shortly be sworn into the bar.